STATE OF NEW YORK
DEPARTMENT OF ENVIRONMENTAL CONSERVATION

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as,

DRUMM 1.

RULING OF THE CHIEF ADMINISTRATIVE LAW JUDGE ON ISSUES AND PARTY STATUS, AND ORDERS OF DISPOSITION

DEC Order No. DMN 06-09

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as,

ALLINGTON 1.

DEC Order No. DMN 08-26

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as,

BOSKET 1.

DEC Order No. DMN 08-15

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as,

SRA3 1.

DEC Order No. DMN 07-39

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as, **STAGE 1.**	DEC Order No. DMN 08-10

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as, **USACK 1.**	DEC Order No. DMN 07-34

In the Matter of the Integration of Interests Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) within an Individual Spacing Unit Known as, **WINTER 1-A.**	DEC Order No. DMN 08-04

Appearances of Counsel:

-- Alison H. Crocker, Deputy Commissioner and General Counsel (Jennifer Hairie of counsel), for staff of the Department of Environmental Conservation

-- The West Firm, PLLC (Thomas S. West and Yvonne E. Marciano of counsel), for well operators Fortuna Energy Inc. (Bosket 1, Drumm 1, SRA3 1, Winter 1-A), Chesapeake Appalachia, LLC (Stage 1 and Usack 1), and East Resources, Inc. (Allington 1)

-- Nixon Peabody LLP (Ruth E. Leistensnider of counsel), for well operator Fortuna Energy Inc. (Drumm 1 and SRA3 1)

-- Mark Scheuerman, General Counsel, for well operator Fortuna Energy Inc. (Usack 1)

-- Lipman & Biltekoff, LLP (Michael P. Joy of counsel), for uncontrolled owners Western Land Services, Inc. (Allington 1, Drumm 1, SRA3 1, and Usack 1), Southwestern Oil Co. and Buck Mountain Associates, Inc. (Stage 1), and Whitmar Exploration Co., Inc. (Winter 1-A)

-- Christopher Denton, for uncontrolled owners W3 Gas Development, LLC (Allington 1) and WLC Gas Holding, LLC (Bosket 1)

RULING OF THE CHIEF ADMINISTRATIVE LAW JUDGE ON ISSUES AND PARTY STATUS, AND ORDERS OF DISPOSITION

Staff of the Department of Environmental Conservation ("Department") proposes to issue compulsory integration orders pursuant to Environmental Conservation Law ("ECL") § 23-0901, integrating mineral interests within the above captioned spacing units. The mineral interests concerned are those relating to the Trenton-Black River natural gas formation.

PROCEEDINGS

Separate compulsory integration hearings, conducted by Department staff pursuant to ECL 23-0901(3)(b), were held on each of these seven natural gas wells. At the integration hearings, the well operator or other uncontrolled mineral interest owners[1] raised objections to the Department's proposed terms of integration.[2] Pursuant to ECL 23-0901(3)(d), based upon the objections raised at the integration hearings, Department staff referred the matters to the Department's Office of Hearings and Mediation Services ("OHMS") for administrative adjudicatory proceedings pursuant to part 624 of title 6 of the Official Compilation of Codes, Rules and Regulations of the State of New York ("6 NYCRR") ("Part 624"). The matters were assigned to Chief Administrative Law Judge ("ALJ") James T.

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[1] "Uncontrolled owners" are mineral interest owners in a well spacing unit who have not entered into a voluntary lease or participation agreement with the well operator (see ECL 23-0901[3][b]).

[2] For a more complete recitation of the entire procedural history of the Drumm 1 proceeding, see Matter of Drumm 1, ALJ Ruling, Sept. 26, 2006, and Matter of Drumm 1, Commissioner Ruling on Motion for Expedited Appeal, Nov. 30, 2007.

McClymonds as presiding ALJ. Because common issues were presented, these matters have been joined for proceedings on joint records, and are being addressed in this joint ruling.

State Environmental Quality Review Act ("SERQA") Status

In July 1992, Department staff published a Final Generic Environmental Impact Statement on the Oil, Gas and Solution Mining Regulatory Program ("GEIS"). On September 1, 1992, Department staff issued a SEQRA (ECL article 8) findings statement concluding that the conduct of compulsory integration hearings pursuant to ECL article 23 would have no significant impact on the environment. Department staff, on behalf of the Department as lead agency, determined that these proceedings are being carried out in conformance with the conditions and thresholds established for compulsory integration hearings in the GEIS and the findings statement. Accordingly, no further action is required under SEQRA (see 6 NYCRR 617.10[d][1]).

Drumm 1, SRA3 1, Usack 1, and Winter 1-A

A joint notice of public legislative hearing and issues conference dated April 4, 2008, was published in the Department's Environmental Notice Bulletin ("ENB") on April 9, 2008, for proceedings on six natural gas wells: Drumm 1 (API No. 31-101-23154-00-00, located in the Town of Bradford, Steuben County); J. Drumm 1 (API No. 31-101-23985-00-00, Town of Thurston, Steuben County); SRA3 1 (API No. 31-097-23072-00-00, Town of Orange, Schuyler County); Usack 1 (API No. 31-015-22933-00-00, Town of Erin, Chemung County); Winkky 1 (API No. 31-015-23950-00-00); and Winter 1-A (API No. 31-107-23855-01-00, Town of Spencer, Tioga County). The notice was also published in the Watkins Glen Review and Express on April 9, 2008, and the Corning Leader, the Elmira Star-Gazette, and the Sayre Morning Times on April 11, 2008.

Timely notices of appearance were filed by well operators Fortuna Energy Inc. and Chesapeake Appalachia, LLC, and by uncontrolled owners Western Land Services, Inc. ("WLS"), and WhitMar Exploration Company, Inc., in accordance with the procedural ruling in Matter of Dzybon, et al. (ALJ Ruling on Procedural Issues, June 6, 2007, appeal pending). No petitions for party status were filed.

A joint legislative hearing was conducted as scheduled in Montour Falls, New York, on May 13, 2008, from 1:00 P.M. to 1:13 P.M. For a summary of comments made at the legislative hearing, see the Ruling of the Administrative Law Judge on Issues and Party Status in Matter of J. Drumm 1, et al. (June 11, 2008, at 3).

A joint issues conference convened at 1:21 P.M. after the conclusion of the legislative hearing. At the conclusion of the issues conference, well operators Fortuna (all units except Usack 1), and Chesapeake Appalachia (Usack 1), stipulated to pay all moneys not in dispute to any owners who have participated through the compulsory integration process (see Drumm 1, et al. Issues Conference Transcript ["IC Trans"], at 208-209). No objections were raised to the well operators' stipulation. The issues conference concluded at 5:40 P.M.

After the issues conference, the presiding ALJ denied Fortuna's motion to stay proceedings in Winter 1-A pending resolution of a title dispute between it and WhitMar Exploration commenced in Supreme Court, Tioga County (see Matter of Winter 1-A, ALJ Ruling on Motion to Stay Proceeding, May 20, 2008). The ALJ ruling was affirmed by the Commissioner on appeal (see Ruling and Interim Decision of the Commissioner, Oct. 20, 2008).

The presiding ALJ subsequently severed the proceedings in J. Drumm 1 and Winkky 1 from the remaining proceedings, and joined J. Drumm 1 and Winkky 1 with the appeals pending in Matter of Beach W1, et al. (see Matter of J. Drumm 1, Ruling of the ALJ on Issues and Party Status, June 11, 2008, at 5). Thereafter, post-issues conference briefs and replies were filed by the appearing parties in the remaining proceedings.

Stage 1

After the compulsory integration hearing concerning the Stage 1 well (API 31-015-26058-00-00, Town of Baldwin, Chemung County), but before the matter was referred to OHMS for adjudicatory proceedings, well operator Chesapeake Appalachia moved for summary dismissal of issues raised by uncontrolled owners at the integration hearing. The presiding ALJ denied the motion on procedural grounds (see Matter of Stage 1, ALJ Ruling on Motion for Summary Dismissal, May 30, 2008).

After the matter was referred to OHMS, a notice of public legislative hearing and deadline for the filing of

notices of appearance and petitions for party status dated June 16, 2008, was published in the June 18, 2008, ENB. The notice was also published in the Corning Leader on June 19, 2008, and the Elmira Star-Gazette on June 20, 2008.

Timely notices of appearance were filed by well operator Chesapeake Appalachia, and uncontrolled owners Southwestern Oil Co. and Buck Mountain Associates, Inc. No petitions for party status were filed.

The legislative hearing was conducted as scheduled in Elmira, New York, on July 16, 2008, from 5:00 P.M. to 5:30 P.M. Three persons attended the hearing and one person spoke. Rachel Treichler, an attorney representing landowners in the gas leasing process, spoke in favor of Department staff's position concerning uncontrolled owners' access to well data and site access, and urged that an environmental impact statement be prepared for the Stage 1 well. No other oral or written comments were provided. At the close of the legislative hearing, the ALJ notified attendees that the issues conference was scheduled for July 24, 2008.

The issues conference was conducted on July 24, 2008, as scheduled. Thereafter, Chesapeake filed an August 15, 2008, post-issues conference brief, and Department staff and the uncontrolled owners filed replies on August 29, 2008. The presiding ALJ granted WLC Gas Holding, LLC, an uncontrolled owner in the Bosket 1 proceeding, and Fortuna, the well operator in Bosket 1, amicus status in Stage 1. WLC Gas Holding filed an amicus brief dated August 29, 2008. Fortuna had previously offered an amicus filing dated April 4, 2008.

On August 5, 2009, counsel for uncontrolled owners Southwestern Oil and Buck Mountain informed the presiding ALJ that the parties to the Stage 1 unit had entered into a confidential settlement agreement resolving all issues concerning the draft integration order. Consistent with the Department's Organization and Delegation Memorandum 94-13, Chesapeake filed a signed, written statement dated August 24, 2009, confirming that based upon the execution of a confidentiality agreement, it withdrew all objections raised in its July 9, 2009, notice of appearance. A signed statement from the uncontrolled owners withdrawing all issues raised in their notices of appearance was filed October 6, 2009.

The presiding ALJ informed the parties to the Stage 1 proceeding by email that their arguments on the issue of the

well operator's authority to drill prior to the completion of integration proceedings would be incorporated into and considered in the other proceedings in which the issue is raised. Accordingly, issues conference exhibits 5A through 14 offered in Stage 1 are entered into the issues conference record in the Bosket 1 and Winter 1-A proceedings (see Matter of Drumm 1, et al. Issues Conference Exhibit List, attached).

Allington 1 and Bosket 1

A joint notice of legislative hearing and deadline for the filing of notices of appearance and petitions for party status dated September 9, 2008, was published in the September 10, 2008, ENB for the Allington 1 (API 31-015-26096-00-00, Town of Horseheads, Chemung County) and Bosket 1 (API 31-101-26073-00-00, Town of Campbell, Steuben County) natural gas wells. The notice was also published in the Corning Leader and the Elmira Star-Gazette on September 17, 2008.

Timely notices of appearance were filed by uncontrolled owners WLS and W3 Gas Development, LLC (Allington 1), and WLC Gas Holding, LLC (Bosket 1). By letter dated October 16, 2008, well operator East Resources (Allington 1) raised objections to issues raised by W3 Gas Development, and informed the presiding ALJ that WLS and Fortuna had entered into a joint operating agreement with East Resources. Accordingly, East Resources argued that all issues were rendered moot in Allington 1. Both well operators East Resources, Inc., and Fortuna (Bosket 1) appeared at the joint legislative hearing and issues conference.

1. Legislative Hearing

The legislative hearing was convened on October 20, 2008, at 1:00 P.M. in Horseheads, New York. Nine people attended the hearing, and two attendees gave oral statements.

Vincent Stalis, president of Buck Mountain Association, raised three issues he wished to have considered in these or future proceedings. The issue concerned (1) whether well production data would be provided to uncontrolled owners during the pendency of integration proceedings; (2) whether ECL article 23 authorizes the deduction of gathering line and compression fees from uncontrolled owners; and (3) whether

article 23 requires royalties to be paid during the 200 percent risk penalty recovery phase of production.

Christopher Denton, Esq., counsel to the New York Natural Resource Owner's Association, addressed the issue concerning the well operators' authority to drill prior to the completion of the compulsory integration process. Mr. Denton argued against allowing well operators to drill prior to the issuance of a final order of integration. In the alternative, Mr. Denton argued that if the well operators are allowed to drill prior to integration, non-participating owners should not be charged the 200 percent risk penalty under the statute.

Because no other oral statements were offered, the legislative hearing concluded at 1:25 P.M.

2. Issues Conference

At the issues conference on Bosket 1, WLC Gas Holding withdrew all issues raised at the compulsory integration hearing except the well data and site access issue, and the issue concerning the well operators' authority to drill prior to completion of the integration process. With respect to the prior drilling issue, WLC Gas Holding relied on its amicus brief in Stage 1.

During the issues conference on Allington 1, W3 Gas Development withdrew all issues. In addition, the ALJ confirmed that WLS had entered into a joint operating agreement with East Resources and Fortuna, and that East Resources had transferred its interest in the Allington 1 well to Fortuna (see Allington 1, et al. IC Trans, at 41-42). Because all issues had been either waived or settled and, thus, no issues remained for adjudication, the matter was remanded to Department staff to issue a final compulsory integration order. The final integration order was issued January 16, 2009 (see DEC Order No. DMN 08-26). Accordingly, the adjudicatory hearing record in Allington 1 may now be closed.

DISCUSSION

Standards for Adjudication

The purpose of an issues conference is, among other things, to hear, identify, narrow and potentially resolve the issues raised by the issues conference participants, and to determine party status for any subsequent adjudicatory proceedings (see 6 NYCRR 624.4[b][2]). With respect to party status, I have concluded that, in addition to Department staff, the well operators and all uncontrolled owners in a spacing unit are mandatory parties under Part 624 for purposes of administrative adjudicatory proceedings on proposed integration orders under Article 23 (see 6 NYCRR 624.5[a]; Matter of Beach W1, et al., Ruling of the Administrative Law Judge on Issues and Party Status, March 14, 2008, at 6-10, appeal pending; Matter of Dzybon, et al., ALJ Ruling on Procedural Issues, June 6, 2007, at 6-8, appeal pending).[3]

In these cases, the well operators Fortuna and Chesapeake Appalachia, and all uncontrolled owners filing notices of appearance are mandatory parties. No petitions for party status were otherwise filed by third parties to the spacing units and, accordingly, party status need not be addressed further.

With respect to issues of fact raised by the mandatory parties, the purpose of an issues conference is to narrow or resolve disputed fact issues without resort to taking testimony, and hear argument on whether unresolved issues of fact meet the standard for adjudication provided for in 6 NYCRR 624.4(c) (see 6 NYCRR 624.4[b][2][ii], [iii]). With respect to issues of law, the issues conference is used to determine whether legal issues exist whose resolution is not dependent upon disputed facts and, if so, to hear argument on the merits of those issues (see 6 NYCCR 624.4[b][iv]). The standard for adjudication for issues raised by mandatory parties is whether the issue (1) relates to a dispute between Department staff and a well operator or uncontrolled owner over a substantial term or condition of the proposed integration order, or (2) relates to a matter cited by

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[3] The rationale for treating the well operators and uncontrolled owners as mandatory parties under Part 624 is articulated in the ALJ rulings in Beach W1 and Dzybon 1. I incorporate that rationale by reference and, thus, will not repeat it here.

Department staff as a basis to deny the integration order or a proposed term thereof and is contested by the well operator or other uncontrolled mineral interest owner (see 6 NYCRR 624.4[c][1][i], [ii]; Beach W1, et al. ALJ Ruling at 6).

Statutory Background

As has previously been noted, chapter 386 of the Laws of 2005 made significant changes to the provisions of ECL article 23 governing the permitting of, spacing for, and the integration of mineral interests within oil and gas wells in New York State (see, e.g., Matter of Fred Andrews 1-A, Interim Decision of the Commissioner, Jan. 7, 2009, at 2-6). A significant reform of the 2005 amendment was to change the field-wide approach to well unit spacing and integration under the pre-2005 amendments to a unit-by-unit approach. Another significant aspect of the new law was to move unit spacing and integration to earlier in the well development process, preferably before the well was drilled and production started. This is in contrast to the practice under the pre-amendment law, where the establishment of spacing units and the integration of mineral interests did not occur until often long after the subject wells were drilled and production begun. The purposes of these changes was to remove the uncertainty associated with the development of oil and natural gas wells, and to reduce the delay and conflicts among operators and other mineral interest owners that often occurred under the pre-2005 law (see Senate Sponsor Mem in Support, 2005 McKinney's Session Laws of NY, at 2254).

Another especially important goal of the 2005 amendments was to clarify and simplify the potential methods for integrating ownership interests in a well unit absent voluntary agreement among the mineral interest holders (see id.). Central to this reform are statutory provisions expressly recognizing the right of mineral owners to elect their integration status, and clarifying their right to receive a full working interest in a well's production based upon their upfront participation in well costs (see id.). In addition to removing uncertainty from the integration process and reducing conflict, these reforms were intended to allocate risks and responsibilities for oil and gas well development among operators and mineral interest owners, both leased and unleased, on a reasonable and equitable basis (see id.).

For a more detailed explanation of the changes effected by the 2005 amendments, see the Commissioner's Interim Decision in Andrews 1-A (Interim Decision, at 2-6). In sum, the process under the 2005 amendments is as follows. A well operator seeking to develop a well must file with the Department an application for a permit to drill (see ECL 23-0501[2]). To obtain a permit to drill into a particular oil or natural gas formation, the operator must control, through fee ownership, voluntary agreement, or compulsory integration, no less than sixty percent of the acreage within the proposed spacing unit for the well (see id.).

In addition, the applicant must propose a spacing unit for the well (see ECL 23-0501[2][a]). Where the proposed spacing unit conforms to State-wide spacing requirements for the oil or gas formation sought to be developed (see ECL 23-0501[1][b][1]), the Department must publish a notice of intent to issue a well permit in the ENB (see ECL 23-0503[2]). Thereafter, the Department issues the permit to drill, and thereby establishes the spacing unit for the well, as a matter of law and without any further spacing order (see id.). Where the proposed spacing unit does not conform to State-wide spacing requirements, section 23-0503(3) provides a procedure for noticing and issuing a spacing order upon a determination by Department staff that the non-conforming unit satisfies the policy objectives of ECL 23-0301.

With respect to the integration of mineral interests in a spacing unit, if at the time the permit to drill is issued, the well operator does not control all owners within the spacing unit, either through lease or voluntary agreement, the Department initiates compulsory integration proceedings (see ECL 23-0901[3][b]). These proceedings involve notice to uncontrolled owners and the distribution of election forms to those owners (see ECL 23-0901[3]). An uncontrolled owner may elect to participate as an integrated participating owner, an integrated non-participating owner or a royalty owner (see ECL 23-0901[3][c][2]). An integrated participating owner ("IPO") is an owner who elects to participate in the initial well in a spacing unit, pays all costs associated with participation, and complies with all of the requirements for participation (see ECL 23-0901[3][a][2]). A non-participating owner ("NPO") is an owner who elects to reimburse the well operator, out of production proceeds, if any, for the owner's proportionate share of actual well costs, subject to a risk penalty of 200 percent of well costs (see ECL 23-0901[3][a][1]).

After the election forms are filed, Department staff convenes a compulsory integration hearing where the elections are ratified, and objections to the terms of integration are heard. If no substantive and significant issues are raised at the integration hearing, a final integration order is issued (see ECL 23-0901[3][e]). If substantive and significant issues are raised at the integration hearing, the matter is referred to OHMS for adjudicatory proceedings and final decision by the Commissioner before the final integration order is issued (see ECL 23-0901[3][d]).

Issues Presented for Adjudication

A. Well Operators' Authority to Drill Prior to Completion of the Compulsory Integration Process (Bosket 1 and Winter 1-A Units)

An issue common to the Bosket 1 and Winter 1-A proceedings concerns the well operators' authority to drill a natural gas well prior to completion of the compulsory integration process and the issuance of a final order of integration.[4] The issue concerns a provision of article 23 governing well permit applications, which provides:

> Every person who applies for a permit to drill an oil or gas well . . . shall provide the Department with: . . . A demonstration that the applicant controls the oil or gas

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[4] Written submission on this issue were filed by the parties to the Stage 1 proceeding in response to Chesapeake Appalachia's pre-issues conference motion for summary dismissal and interim relief. In addition, the parties to the Bosket 1 proceeding were granted amicus status in Stage 1 by the ALJ, and submitted briefs on the issue in that proceeding. The parties in Winter 1-A have relied upon the written submissions in Stage 1 on this issue. As noted above, Stage 1 has since been settled. As also noted above, the written submissions in Stage 1 relied upon by the parties in the remaining units have been made a part of the record here and considered in connection with this issue (see Drumm 1, et al. Issues Conference Exhibits ["IC Exhs"] 5A-14).

Oral arguments on this issue were made during the issues conference in Drumm 1, et al. (see Drumm 1, et al. IC Trans, at 170-207).

> rights, as applicable, in the target formation to be penetrated by the wellbore, provided that, if the applicant does not control such oil or gas rights, the department shall issue a permit that is conditional upon the applicant completing the integration process required by section 23-0901 of this article before the applicant can exercise the right to drill . . . under the permit

(ECL 23-0501[2][b]).

1. Positions of the Parties

Uncontrolled owners in the Bosket 1 and Winter 1-A units challenge Department staff's failure to condition well permits pursuant to section 23-0501(2)(b) when the well operator controls less than 100 percent of the mineral rights for a target formation in any given unit. In other words, the uncontrolled owners argue that before a well operator may receive an unconditional permit to drill into the Trenton-Black River ("TBR") natural gas formation in a spacing unit, the operator must control 100 percent of the mineral interests in the TBR in that unit. For units, such as Bosket 1 and Winter 1-A, where the well operator does not control 100 percent of the TBR mineral interests in the unit, the uncontrolled owners argue that the operators may not drill or bring a well into production until after a final order of integration for the unit is issued by the Department.

The uncontrolled owners assert that by allowing the operators to drill prior to the completion of the integration process undermines one of the key legislative goals of the 2005 amendments, namely, to reverse the order of events under the old law. The 2005 amendments establish a process whereby all decision making concerning integration occurs prior to the development of a well and during a time when the element of risk still exists for all parties. Allowing drilling prior to integration allows operators the "free look" at well productivity prior to integration that the 2005 amendments sought to avoid, according to the uncontrolled owners. Moreover, the uncontrolled owners argue that allowing pre-integration drilling deprives them of the benefits of receiving well data and access to the drilling rig at the time the well is being drilled. The uncontrolled owners also assert that the practice complicates decision making concerning drilling

operations subsequent to the initial drilling episode, which often occurs in TBR wells, or the construction of surface facilities. In addition, the uncontrolled owners are concerned that they will be prevented from participating as an IPO at cost. Instead, they fear that their participation will be limited to either NPO status, and thus subject to a risk penalty, or to a royalty interest, as the Department has proposed in the transition well context where the well has been drilled prior to integration.

Department staff disputes the uncontrolled owners' reading of section 23-0501(2)(b). Department staff asserts that section 23-0501(2)(b) only requires a demonstration that the mineral interests of the parcels within the unit through which the wellbore passes are controlled, not the mineral interest for the entire unit. Staff contends that the uncontrolled owners reading of section 23-0501(2)(b) conflicts not only with the plain meaning of the statute, but also its legislative history and purpose. In support of its position, staff submits the affidavit of staff member Kathleen Sanford, Permits Section Chief, Bureau of Oil and Gas Regulation, Division of Mineral Resources, who was involved in the legislative negotiations leading up to the 2005 amendments (see Sanford Affidavit, IC Exh 6B [attached]).

The well operators agree with and support Department staff's interpretation of section 23-0501(2)(b).

2. Discussion

As an initial matter, the uncontrolled owners' issue raises a challenge, at least in part, to the terms of the well permits, which are not before me in these proceedings. However, the issue has the potential to impact the integration process and the terms of integration in the final integration orders, which are before me (see 6 NYCRR 624.4[c][i], [ii]). Thus, the issue is reviewable in this proceeding. Moreover, the issue involves a legal issue of statutory construction that is not dependent upon any facts in substantial dispute.[5] Accordingly,

[5] The parties do not dispute that the ownership tabulations for the Bosket 1 and Winter 1-A units indicate less than 100 percent control of those units by Fortuna (see Bosket 1 Ownership Tabulation, IC Exh 3B, DMN 3; Winter 1-A Ownership Tabulation, IC Exh 3E, DMN 3). Nor do the parties dispute that Department staff issued well permits without the section 23-0501(2)(b)

the issue may be resolved at the issues ruling stage of these proceedings (see 6 NYCRR 624.4[b][2][iv], [5][iii]).

Starting with the plain language of the statute (see Majewski v Broadalbin-Perth Cent. School Dist., 91 NY2d 577, 583 [1998]; McKinney's Cons Laws of NY, Book 1, Statutes § 94), Department staff has the better reading. Section 23-0501(2)(b) expressly requires the well operator to demonstrate that it controls all gas rights "in a target formation" for those parcels "to be penetrated by the wellbore" to receive an unconditional permit to drill. A fair reading of the statute supports the conclusion that both the terms "in the target formation" and "to be penetrated by the wellbore" modify the term "gas rights." The term "in the target formation" limits the relevant gas rights to those of the target gas bearing formation sought to be developed. For example, where the target formation sought to be developed is the TBR natural gas formation, the term limits the relevant mineral interests to gas rights in the TBR.

The term "to be penetrated by the wellbore" further modifies the term "gas rights." In other words, to obtain an unconditional permit to drill, the operator must demonstrate control of the gas rights proposed to be penetrated by the wellbore. Thus, where a well operator proposes to develop the TBR, the operator need only demonstrate that it controls the TBR gas rights in the parcels within a spacing unit through which the wellbore passes.

The uncontrolled owners' reading of the statute as requiring the well operator to control all target gas interests in a unit before it may receive an unconditional permit to drill conflates the two statutory clauses. They read the term "to be penetrated by the wellbore" as modifying "in the target formation," not "gas rights." This reading, however, renders the term "to be penetrated by the wellbore" superfluous. If the Legislature intended for the well operator to control all gas interests in the target formation, no reason exists to add the additional modifier "to be penetrated by the wellbore" to the term "gas rights in the target formation." Principles of statutory construction disfavor interpretations that render

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condition for the subject wells, presumably based upon a showing by Fortuna that it controlled the mineral interests through which the wellbore was proposed to pass. Accordingly, no facts relevant to this issue are in material dispute.

terms superfluous (see Matter of OnBank & Trust Co., 90 NY2d 725, 731 [1997]; Statutes § 98[a]).

Moreover, when the Legislature intended for a well operator to control all or some portion of the target gas interests in a unit, it consistently refers to the "spacing unit," not "the target formation to be penetrated by the wellbore," to do so. For example, to apply for a well permit, the operator must "control . . . no less than sixty percent of the acreage within the proposed spacing unit for such well" (ECL 23-0501[2] [emphasis added]). A compulsory integration hearing is required when upon issuance of a well permit, the well operator "does not control all owners within the spacing unit" (ECL 23-0901[3][b] [emphasis added]). By using the term "wellbore" in section 23-0501(2)(b), it is reasonable to conclude that the Legislature intended for a well operator to control all gas rights in the parcels through which the wellbore is proposed to pass, as asserted by Department staff, not all gas rights within the spacing unit, as the uncontrolled owners assert. Consistent with other statutory sections, if the Legislature had intended for the well operator to control all owners "within the spacing unit" to obtain an unconditional permit to drill, it would have said so.

Reference to the legislative history and purpose of section 23-0501(2)(b) further supports Department staff's reading (see Riley v County of Broome, 95 NY2d 455, 463-464 [2000]; Statutes §§ 95, 124). As explained by Ms. Sanford, whose affidavit in Stage 1 and explanation at the issues conference in Winter 1-A are uncontradicted by the parties, during the negotiations that led to the 2005 amendments, well operators negotiated for the ability to drill wells prior to the issuance of integration orders. The operators were concerned that if control of an entire unit was required before drilling could commence, an uncontrolled mineral rights owner with a very small amount of acreage could hold up drilling to the detriment of other owners in the unit (see Sanford Affid, at ¶ 11; Drumm 1, et al. IC Trans, at 182-184). This delay could result in the loss of drilling opportunities due to rig scheduling, and the expiration of leases (see id.). On the other hand, a competing concern was that well operators would trespass on uncontrolled interests if the wellbore passed through an uncontrolled parcel (see id.). Accordingly, section 23-0501(2)(b) was adopted to allow the well operator to drill prior to the issuance of an integration order, where one was required, except where the path of the wellbore included an uncontrolled tract.

Contrary to the uncontrolled owners' assertion, allowing a well operator to drill prior to issuance of an integration order does not unduly limit the participation rights of an uncontrolled owner, particularly one seeking IPO status. As Department staff made clear, based upon the assertion by well operators that drilling prior to the integration order would be rare, section 23-0501(2)(b) was adopted with industry's clear understanding that pre-integration order drilling would be at the well operators' sole risk, and without prejudice to the uncontrolled owners' right to elect their participation status as set out in article 23 (see id.; IC Trans, at 186-187). In addition, well operators also understood that by drilling prior to integration, they would potentially be providing uncontrolled owners with a "free look" at well productivity (see Department Staff's Post-Issues Conference Brief [Drumm 1, et al.], at 8). Thus, Department staff stated that it would not seek to charge an IPO a risk penalty where the well operator has drilled a well prior to the integration order and provided a "free look" at well productivity prior to integration.

Indeed, Department staff did precisely what it said it would do in these cases. Both the Bosket 1 well and the Winter 1-A well were drilled prior to the issuance of the integration orders for those wells. In Winter 1-A, WhitMar Exploration sought integration as an IPO and, in its proposed integration order, staff accepted WhitMar's election (see Matter of Winter 1-A Draft Order No. DMN 08-04, IC Exh 3E, Exhs DMN 9, DMN 10). Nothing in the record indicates that Department staff imposed a risk penalty upon WhitMar. Accordingly, WhitMar's participation in the Winter 1-A unit as an IPO has not been prejudiced by Fortuna's decision to drill prior to completion of the integration process.

Similarly, in Bosket 1, WLC Gas Holding elected to participate as an NPO, which Department staff accepted (see Matter of Bosket 1 Draft Order No. DMN 08-15, IC Exh 3B, Exhs DMN 5, DMN 6). Thus, WLC's determination to participate in the Bosket 1 unit has not been prejudiced by Fortuna's decision to drill prior to issuance of the integration order.

With respect to the uncontrolled owners' argument that allowing pre-integration drilling deprives them of the right to well data and well site access contemporaneous with well drilling operations, whether uncontrolled owners are entitled to contemporaneous well data and site access is an open question presently pending in other proceedings (see Access to Well Date/Well Site Access Issue, below). Whether or not

uncontrolled owners have the right asserted, the statute clearly allows pre-integration drilling in the circumstance presented here. I will reserve decision until after the issue of the uncontrolled owners' right to well data and site access is resolved before addressing whether pre-integration drilling improperly deprives them of their rights.

At the compulsory integration hearing in Bosket 1, WLC argued that if the Department was going to allow well operators to drill prior to integration, the following condition should be added to the integration order:

> In the event that the well operator shall commence any drilling prior to the issuance of the final order of integration, no risk penalty shall be assessed for such drilling costs as were incurred before the dated of issuance of said order.

WLC contended that this provision is supported by ECL article 23. WLC has not further elaborated upon, in briefing or oral argument, the statutory authority for this condition. At the legislative hearing in Bosket 1, however, the New York State Natural Resource Landowner's Association ("NYSNRLA") (represented by the same counsel as represented WLC) argued that the Department should impose this condition pursuant to its power to issue integration orders on terms and conditions that are "just and reasonable" to prevent alleged abuse by the well operators (see ECL 23-0901[3]).

With respect to IPOs, this issue is academic. As noted above, Department staff is not imposing a risk penalty against IPOs when the well operators drill prior to completion of the integration process. With respect to NPOs, the implication of this proposal is that if a well operator drills prior to integration, the NPO would reimburse the well operator out of production proceeds for the NPO's proportionate share of actual well costs without paying a risk penalty (see ECL 23-0901[3][a][1]). In other words, the NPO's share of well costs would be financed up front by the well operator, and would be recouped by the operator from production proceeds without payment of a risk penalty.

To the extent WLC argues its condition as a penalty for drilling prior to integration where the well operator controls all parcels within a spacing unit penetrated by the wellbore, the issue is rendered academic by the conclusion that

the statute authorizes drilling in that context. To the extent WLC argues its condition as a penalty for drilling prior to integration where the well operator does not control all parcels within a spacing unit penetrated by the wellbore, no statutory provision authorizes such a penalty in addition to those already provided for (see ECL 71-1301, et seq.).

To the extent WLC adopts the NYSNRLA position that the condition should be imposed even when drilling prior to integration is statutorily authorized, as it is, WLC has failed to identify a statutory basis for imposing the condition and relieving NPOs of the obligation to pay a risk penalty when the well operator has drilled prior to integration (see Senate Sponsor Mem in Support, 2005 McKinney's Session Laws of NY, at 2254 [risk penalty is for owners who wish to make no up front investment in a well, but wish to obtain a potentially greater share in revenue]). Moreover, WLC has failed to make a showing on this record sufficient to require adjudication of factual issues concerning the exercise of the Department's authority to impose "just and reasonable" terms of integration, even assuming without deciding that that authority may be exercised to waive the NPO's statutory risk penalty obligation in this circumstance.

In sum, under section 23-0501(2)(b), a well operator has the right to drill a well upon issuance of a well permit and prior to issuance of an integration order, provided the well operator controls the relevant mineral interests in the parcels within a spacing unit through which the wellbore passes. If the operator exercises that right, however, it does so at its sole risk and without prejudice to the uncontrolled owners' right to elect their participation status under article 23. On the other hand, if the well operator does not control the mineral interests in the parcels through which the wellbore passes, the well permit will contain a condition requiring completion of the title 9 integration process before the right to drill may be exercised by the well operator. Any violation of this condition would potentially expose the well operator to enforcement proceedings.

B. Costs for Subsequent Operations Conducted Prior to Integration (Winter 1-A)

In its notice of appearance and at the issues conference in Winter 1-A, Fortuna raised an issue concerning the extent of an uncontrolled owners' obligation to pay original downhole costs for wellbores not used in a sidetrack well. Fortuna argued that at the time of integration, an uncontrolled owner is responsible for sharing in the costs of all wellbores leading to a successful sidetrack, including wellbores that did not successfully produce gas. WhitMar, on the other hand, argued that it was only responsible for the costs of drilling the sidetrack, and only that portion of the original wellbore from the surface to the sidetrack. Department staff supported WhitMar's position and proposes to charge WhitMar only those costs.

After Fortuna's motion to stay the Winter 1-A proceeding pending resolution of the title dispute between Fortuna and WhitMar in Supreme Court, Tioga County, was denied by the presiding ALJ and affirmed by the Commissioner (see Matter of Winter 1-A, ALJ Ruling on Motion to Stay Proceedings, May 20, 2008, affirmed by Ruling and Interim Decision of the Commissioner, Oct. 20, 2008), Fortuna withdrew its objection to Department staff's position concerning the costs that may be charged to WhitMar in connection with this proceeding (see Email from Thomas S. West, Esq., to James T. McClymonds, Chief Administrative Law Judge, dated Nov. 14, 2008). Accordingly, the issue is resolved and will not be the subject of further adjudication in this proceeding.

C. Transition Wells -- Applicability of Laws of 2005, Chapter 386 (Drumm 1, SRA3 1, and Usack 1 Units)

Both well operators Fortuna and Chesapeake Appalachia raise the issue whether the Laws of 2005, chapter 386 govern the compulsory integration of interests for transition wells. Transition wells are wells that were permitted prior to August 2, 2005, the effective date of the 2005 amendments to article 23, but for which a spacing and compulsory integration order had not been issued. The Drumm 1, SRA3 1 and Usack 1 wells all fall into the transition well category. The permit to drill Usack 1 was issued July 17, 2001, the SRA3 1 permit was issued December 1, 2003, and the Drumm 1 permit was issued September 9, 2004. As of August 2, 2005, no spacing or compulsory integration order had been issued for these three wells.

The well operators assert that although the 2005 amendments govern the establishment of spacing units for transition wells (see ECL 23-0503[5]), the compulsory integration of interests in those units are governed by title 9 of article 23 as it existed prior to the 2005 amendments. The well operators acknowledge that I have previously ruled that article 23, title 9, as amended in 2005, applies to the compulsory integration of interest for transition wells (see Drumm 1, ALJ Ruling, Sept. 26, 2006, at 3-6; Fred Andrews 1-A, ALJ Summary Report, May 22, 2007, at 5-9; Beach W1, et al., ALJ Ruling, March 14, 2008, at 10-16). Nevertheless, they request that I reconsider those rulings.

The well operators' request for reconsideration is granted and, upon reconsideration, and particularly in light of the Commissioner's interim decision in Fred Andrews 1-A (Interim Decision, Jan. 7, 2009), I adhere to my prior rulings.[6] The Commissioner's interim decision in Fred Andrews 1-A addresses most of the arguments raised here. As the Commissioner noted, under the pre-2005 version of article 23 (the "old law"), spacing orders were issued separately, and often long after, well permits were issued (see id. at 2). Generally, spacing orders were issued on a natural gas field-wide basis, with multiple units in a field established in a single order (see id.). In addition, if uncontrolled mineral interests existed within the field, those interests were integrated in an integration order that was issued contemporaneous with the spacing order (see id. at 3-4; see also, e.g., Matter of Quackenbush Hill Field, Decision and Order of the Commissioner, Dec. 20, 2002).

As noted above, the 2005 amendments ("new law"), taking a unit-by-unit approach, modified the order of events under the old law. Under the new law, where the well permit applicant proposes a spacing unit that meets State-wide spacing requirements, the spacing unit is established by law contemporaneous with issuance of the well permit (see ECL 23-0503[2]). If the proposed unit does not conform to State-wide spacing requirements, the Department issues a spacing order (see ECL 23-0503[3]). After the spacing unit is established, whether by operation of law or by order, an integration hearing is conducted if any uncontrolled owners remain in the unit (see ECL

[6] The issue presented is a legal issue that does not depend upon the resolution of disputed issues of fact (see 6 NYCRR 624.4[b][5][iii]). Thus, the issue may be ruled upon here.

23-0901[3][b]). Thereafter, a separate compulsory integration order is issued, either after the compulsory integration hearing or after an adjudicatory hearing, if one was required (see ECL 23-0901[3][d], [e]).

With the change in the procedures for well spacing and integration, the 2005 amendments left several wells, including the ones involved here, in the so-called "transitional" category, that is, wells for which a permit to drill had been issued, but for which the necessary spacing orders and integration orders had not been issued under the old law. As noted by the Commissioner, the Legislature expressly recognized the transition well situation, and made express provision for their spacing and integration under the new law (see Andrews 1-A, Interim Decision, at 8-11). Chapter 386 of the Laws of 2005 explicitly states that it is applicable not only to gas well permits issued on or after August 2, 2005, the new law's effective date, but also to "any . . . spacing order issued on or after" that date (L 2005, ch 386, § 10). In addition, the 2005 amendments include a provision for establishing a spacing unit by spacing order for "wells permitted prior to the effective date of this section where a spacing order is required but has not been issued" (ECL 23-0503[5]), which includes every well in the transition category.[7]

Because the new law applies to spacing orders issued after August 2, 2005, including spacing orders issued pursuant to ECL 23-0503(5) for transition wells, the new law's provisions governing compulsory integration under ECL article 23, title 9, are also expressly applicable to those spacing orders (see L 2005, ch 386, § 10; see also Andrews 1-A, Interim Decision, at 9-11). By its express terms, the 2005 act, which includes the act's amendments to title 9, are applicable to "any . . . spacing order issued on or after" August 2, 2005 (L 2005, ch 386, § 10).

Nothing in the well operators' arguments justifies a departure from the new law's plain terms. The well operators argue that ECL 23-0901(3)(b) links compulsory integration to well permits issued contemporaneously with the establishment of a spacing unit, and that the new law's integration provisions

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[7] The new law does not provide for spacing units as a matter of law for transition wells permitted prior to the effective date of the new law (see Andrews 1-A, Interim Decision, at 10 n3; ECL 23-0503[5]). This is in contrast to wells permitted after the new law's effective date.

cannot be applied to spacing units that do not exist when the well permit is issued. However, as noted by the Commissioner in Andrews 1-A, the lack of a spacing unit for transition well permits is cured by application of ECL 23-0503(5), and nothing in the new law prevents application of its integration procedures for well permits spaced under ECL 23-0503(5) (see Andrews 1-A, Interim Decision, at 9-12).

The well operators also point to ECL 23-0901(3)(c)'s requirement that they provide uncontrolled owners at the integration hearing with "estimated" well costs, and note that this section does not mention "actual" costs, which would be available for a well in production. As noted by Department staff, the definition of "well costs" means costs "incurred or estimated to be incurred by the well operator" and, thus, incorporates actual costs if known (ECL 23-0901[3][a][5]). In any event, section 23-0901(3)(c)'s reference only to estimated costs, which would be the ordinary situation in a new law well permitted, spaced and integrated prior to drilling, is insufficient to compel the conclusion that the Legislature intended the old law integration provisions to apply to transition wells or, for that matter, to new law wells permitted and drilled prior to integration.

The well operators also argue that if the Legislature had intended title 9 to apply to transition wells, it would have provided that the act "shall apply to any oil or gas well permit or spacing order or any compulsory integration order issued on or after such effective date" (Chesapeake Appalachia Post-Issues Conference Brief, at 7 [emphasis added]). The suggested additional language was not necessary, however. By applying the new law to either well permits or spacing orders issued after the new law's effective date, the Legislature unambiguously indicated its intent to apply the new integration procedures to those well permits or spacing orders.

Moreover, taking the well operators' argument to its logical conclusion would produce absurd results. The operators' theory is that by leaving out a reference to integration orders in section 10, the Legislature expressed its intent that the new law's integration provisions not apply to spacing orders issued after the effective date. If this is so, the failure to reference integration orders would have to also indicate the Legislature's intent that the integration provision not apply to well permits issued after the effective date as well. Clearly, the Legislature did not intend such a result.

Contrary to the well operators' assertions, a "whole language" reading of the new law and the presumption against retroactivity similarly do not compel divergence from the Legislature's clearly expressed intent. As noted by the Commissioner, the plain language, structure, and purposes underlying the new law clearly evince the Legislature's intent that the new law's integration provisions apply to transition wells (see Andrews 1-A, Interim Decision, at 9-11). Moreover, application of the new law to transition wells spaced under ECL 23-0503(5) does not result in the retroactive application of the new law in derogation of vested rights (see id. at 11-12).

The well operators argue that applying title 9 of the new law to transition wells is inconsistent with the legislative goal of eliminating the ability of an uncontrolled owner to obtain a full working interest without a risk penalty after having a "free look" at well productivity. Moreover, the well operators assert that applying the new law to transition wells will result in an "absurd dichotomy" between two classes of wells that are "identically" situated from the risk perspective -- that is, wells permitted and spaced under the old law versus wells permitted under the old law and spaced under the new law (Chesapeake Appalachia Post-Issues Conference Brief, at 17-18). In support of this argument, the operators cite to the legislative history of the new law (see Senate Sponsor Mem in Support, 2005 McKinney's Session Laws of NY, at 2254 ["Senate Mem"]).

The legislative history of a statute may not be used to vary the plain terms of a statute, or prevent application of a clear and unambiguous statute as written (see Rubin v City Natl. Bank and Trust Co. of Gloversville, 131 AD2d 150, 151-152 [3d Dept 1987]). Thus, resort to the new law's legislative history does not justify ignoring the law's express application to wells spaced after the effective date of the new law, including transition wells spaced pursuant to ECL 23-0503(5). Nor does the legislative history give any indication that the Legislature intended that transition wells be integrated under the old law, sufficient to justify reading such a requirement into the new law.

To the contrary, consideration of the legislative history supports the plain reading of section 10 of chapter 386. The well operators are correct that one of the legislative goals of the new law was to foster decision making at a point during well development when the element of risk is shared among all interested parties. However, preventing the so-called "free

look” was not the only legislative goal of the new law, nor was it necessarily the most significant. As noted in the Senate sponsor’s memorandum in support of the new law, the law was also intended to remove the uncertainty associated with the process of developing oil and natural gas wells, revise and clarify the procedures for integrating interests, and allocate risks and responsibilities among operators and owners of mineral interests on a reasonable and equitable basis (Senate Mem, at 2254). The Senate memorandum further states that “[m]ost importantly, this legislation fundamentally simplifies the potential methods for integrating ownership interests in a unit in the absence of voluntary agreement by creating three basic options for holders of gas or oil interests” (id. [emphasis added]). Far from causing an “absurd dichotomy,” application of title 9 of the new law to transition wells substantially advances all of these legislative goals, and cures the evils that plagued integration under the old law. On the other hand, applying the old title 9 would frustrate these legislative goals, and continue the inefficiencies and conflicts the Legislature sought to remedy for this group of wells. Thus, the legislative history fully supports applying the new law as written to transition wells, including the compulsory integration provisions of the new title 9.

Finally, to the extent the Third Department in Matter of Western Land Servs., Inc. v Department of Envtl. Conservation of the State of New York (26 AD2d 15 [2005], lv denied 6 NY3d 713 [2006]), a case arising under the old law, noted in its mootness analysis that the new law applies to gas wells permitted after the effective date of the new law, neither the new law nor the issue presented here was before the Third Department. Therefore, the court’s statement cannot be viewed as resolving the issue presented here.

D. Transition Wells -- Transition Well Formula: Application of Risk Penalty to IPOs (Drumm 1, SRA3 1, and Usack 1 Units)

1. Positions of the Parties

Although Department staff agrees that the new law applies to transition wells, it proposes not to apply the new law as written to integrate interests in units associated with those wells, specifically with respect to IPOs. Instead, for uncontrolled owners who seek to participate as IPOs in the transition wells, Department staff proposes to integrate them subject to a risk penalty for well costs incurred by the operator prior to the integration hearing, and only relieve them of the risk penalty for any remaining costs expected to be incurred by the operator after the integration hearing. Department staff contends that this transition well formula is "just and reasonable" because, in the transition well context, the subject wells are already in production and the risk of participating in those wells has been removed at the time of the integration hearing. Staff claims the discretion to adjust the IPOs' participation rights based upon ECL 23-0901(3)(c)(1)(ii)(J), which authorizes staff to include terms in the integration order that are "reasonably required to further the policy objections" of ECL 23-0301.[8]

WLS challenges Department staff's proposal to impose a risk penalty upon it, notwithstanding its election to participate in the transition wells as an IPO, that is, at cost and without a risk penalty. WLS argues that under the new law, Department staff lacks the discretion to modify an IPO's right to participate at cost and without a risk penalty (see ECL 23-0901[3][a][2]).

WLS argues in the alternative that to the extent that Department staff retains the discretion to modify the rights of an IPO as expressly defined by the new law, Department staff's exercise of discretion to impose a risk penalty upon them was arbitrary and capricious, and an abuse of discretion. WLS contends that imposing a risk penalty on uncontrolled owners is

[8] The policy objectives of ECL 23-0301 are to regulate the development, production and utilization of oil and natural gas so as to (1) prevent waste of the resource; (2) maximize the recovery of oil and gas; and (3) protect the correlative rights of all persons, including landowners and the general public, among other things (see ECL 23-0301).

not “just and reasonable” given the history under the old law. WLS alleges that it sought to participate in the transition wells as a working interest at cost, but was rebuffed by the well operators, who would not enter into voluntary agreements with them. This forced uncontrolled owners into compulsory integration where the Department had the practice of integrating uncontrolled owners as royalty interests only. WLS further documents its efforts to obtain a working interest under the old law, first by seeking Declaratory Ruling DEC 23-14 from the Department, through litigation in Matter of Western Land Servs., Inc. v Department of Envtl. Conservation of State of New York, and ultimately through negotiations leading to the new law. Now that the new law expressly recognizes the IPO status, WLS contends that it is particularly unjust to impose the new law’s 200 percent risk penalty upon it when it was prevented from participating as a working interest at cost while the old law was in effect.

The well operators support the Department’s proposal to charge a risk penalty against WLS. Citing Matter of Western Land Servs. (26 AD3d at 20), the well operators argue that the overarching requirement of both the new and old law is that integration orders be issued “upon terms and conditions that are just and reasonable” (see ECL 23-0901[3]; see also ECL former 23-0901[3]). Accordingly, the well operators contend that the Department retains the discretion to modify an uncontrolled owners’ participation rights.

The well operators also note the Third Department’s statement that “[i]t would be unfair for a nonconsenting owner or nondriller lessee to be relieved of the costs and risks associated with drilling a producing well, but at the same time reap the benefits of another’s efforts in extracting oil or gas from beneath his or her land” (26 AD3d at 18). The well operators assert that foreclosing the “free-look” uncontrolled owners received under the old law and preventing risk-free “free-riding” with respect to well development was a major reform of the new law. The well operators argue that under either the old or new law, Department staff is justified in exercising its discretion under the “just and reasonable” provisions of ECL 23-0901(3) to impose a risk penalty to eliminate the “free ride” WLS is attempting to take for the transition wells. The well operators also assert that the 200 percent risk penalty for well costs provided for under the new law is just and reasonable, whether the new or the old law applies.

2. Discussion

The issue whether the Department has the discretion to impose a risk penalty against an uncontrolled owner electing participation in a transition well as an IPO was also represented in Matter of Beach W 1, et al. (ALJ Ruling, at 16-18, appeal pending). In that case, however, I reserved decision on the issue on the ground that its resolution depended upon facts in material dispute (see id. at 18). Specifically, factual disputes remained in Beach W 1 concerning the degree to which information concerning the productivity of the transition wells involved in that case was available to uncontrolled owners at the time of the integration hearings (see id. at 17-18).

In this case, in contrast to Beach W 1, the issue may be decided at the issues ruling stage of the proceeding. The facts concerning the availability of information concerning well productivity at the time of the integration hearings for the transition wells involved here are not in material dispute. For example, the integration hearing for the Drumm 1 well was held in May 2006. At the time of the hearing, the cost and revenue statement included in the integration package provided to uncontrolled owners indicated that the well, which had commenced production in July 2005, had produced over $9 million in revenues by March 31, 2006 (see Affidavit of Guido Struyk, ¶ 10 and Exh B). In addition, the confidentiality period provided for under ECL 23-0313 for well data filed with the Department had expired in March 2005 (see id., ¶¶ 5-10). Thus, production data for the Drumm 1 well was available to uncontrolled owners at the time of the integration hearing.

Similarly, the integration hearing for the SRA3 1 well, which commenced production in October 2004, was conducted in October 2007. The cost and revenue statement for the SRA3 1 well indicated that not only had the well produced over $21 million in revenues by July 2007, but that the well costs incurred to August 31, 2007, had already been recouped by the time of the integration hearing (see id. ¶¶ 16-18 and Exh D). In addition, the confidentiality period for SRA3 1 well data had expired in December 2005 (see id. ¶ 15).

With respect to the Usack 1 well, which had begun production in September 2002, the compulsory integration hearing was conducted in September 2007. The cost and revenue statement for the Usack 1 well showed that by April 2006, the Usack 1 well had produced over $3.3 million in revenues (see Affidavit of James E. Grey, ¶ 13 and Exh D). The confidentiality period for

Usack 1 well data had expired in October 2003 and, thus, was publically available to uncontrolled owners by the time of the integration hearing (see id. ¶¶ 7-8 and Exh B).

Also undisputed are the steps WLS took prior to the Legislature's adoption of the 2005 amendments in an effort to obtain a working interest in the transition wells, including the unsuccessful negotiations with well operators, its petition for Declaratory Ruling No. 23-14, and its CPLR article 78 proceeding in Matter of Western Land Servs. (see Affidavit of Jeffrey Cook; Affidavit of John K. Wilson).[9] Thus, because no factual issues relevant to the legal issue are in material dispute, the legal question may be decided at this point in the proceeding (see 6 NYCRR 624.4[b][5][iii]).

As an initial matter, the issue presented is not as broad as the well operators' quotation from Matter of Western Land Servs. might suggest. WLS does not argue that it should be relieved of its statutory obligation to pay its proportionate share of well costs in order to participate as an IPO in the transition wells (see ECL 23-0901[3][a][2]). Thus, the "free-riding" the well operators reference is limited only to the premium, in the form of the risk penalty, a well operator ordinarily receives from an NPO who elects to pay its share of well costs out of production proceeds (see ECL 23-0901[3][a][1], [4]). On the narrow issue whether an IPO that has elected to pay its share of well costs in full at the integration hearing may be charged a risk penalty in the transition well context, I conclude that Department staff erred.

The 2005 amendments contain no express provision charging an IPO in the transition well context a risk penalty for costs incurred prior to the integration hearing. Although the Legislature expressly included a provision addressing spacing orders for transition wells (see ECL 23-0503[5]), it did not include a risk penalty for IPOs in that provision, or any other provisions of the 2005 amendments. This is in contrast to other provisions governing situations where a well might be in production when an uncontrolled owner makes an election to participate in the well. For example, under ECL 23-0503(6), which governs orders modifying existing spacing units, the Legislature expressly specified the election options for new owners added to a modified unit, both during and after the

[9] Although the parties do not dispute the factual assertions WLS makes regarding these efforts, they do dispute their relevance to this proceeding.

completion of the risk penalty phase. Similarly, under ECL 23-0901(3)(c)(1)(ii)(E) and (H), which govern the construction of surface facilities beyond the wellhead and the conduct of subsequent operations on a well, respectively, the Legislature again expressly specified the election options of uncontrolled owners.

Thus, when the Legislature saw fit to adjust election options to address unique circumstances, including circumstances where uncontrolled owners have a "free-look" at well production through no fault of their own or the well operator, the Legislature expressly did so. The Legislature's failure to adjust the election options of or otherwise impose a risk penalty against an IPO in the express statutory provision governing transition wells raises the inference that the Legislature did not intend that IPOs be charged a risk penalty in the transition well context (see Matter of Chemical Specialties Mfrs. Assn. v Jorling, 85 NY2d 382, 394 [1995]; Statutes § 240).

Department staff recognizes that the 2005 amendments contain no express language imposing a risk penalty on IPOs for transition wells. Nevertheless, staff asserts that it is just and reasonable to impose such a penalty in order to take into account the lack of risk faced by IPOs at the time of their election in the transition well context. Citing the provisions of the new law that allow an NPO to buy out of the risk penalty and become an IPO, staff concludes that IPO and NPO status is flexible. Focusing on the portion of the statute that defines risk penalty as "the percentage applied to well costs to reimburse the well operator for the risk involved with the exploration for and development of the well" (ECL 23-0901[3][a][3]), staff further concludes that the Legislature intended the Department to take risk into account during compulsory integration. Relying on the Department's authority to include terms in an integration order that are "reasonably required to further the policy objectives of section 23-0301" of article 23 (ECL 23-0901[3][c][1][ii][J] ["subsection (J)"]), staff asserts the discretion to account for well specific circumstances and impose the transition formula upon IPOs.

Settled principles of statutory construction support the conclusion that Department staff lacks discretion under subsection (J) to modify the rights of an IPO as defined under ECL 23-0901(3)(a)(2). First, the plain language of subsection (J) provides that "[o]ther terms may be included in the order of integration" that are reasonably required to further article

23's policy objectives. This general grant of discretion follows a list of specific terms required to be included in any integration order that govern the post-integration relationship between the well operator and uncontrolled owners with respect to well operations (see ECL 23-0901[3][c][1][ii][A]-[I]). Thus, under settled principles of statutory construction, the general grant of discretion in subsection (J) must be interpreted as applying to subject matter similar to that enumerated in subsections (A) through (I), that is, terms that regulate post-integration operations and the parties' relationship thereto (see Statutes § 239[b]). Moreover, use of the language "other terms may be included" suggests that the grant of discretion is additive, that is, that the Department may add terms in addition to those specified in subsections (A) through (I), but not modify them.

On the other hand, the rights of IPOs and NPOs, and the parameters of the risk penalty, are not specified in the subsections preceding (J), but appear in a definitional subsection of the statute. In addition, the risk penalty staff proposes to impose is not an operational condition, but a cost for participation. Thus, the risk penalty does not appear to be similar to the types of terms included in subsections (A) through (I). Accordingly, Department staff's discretion under subsection (J) does not encompass the authority to impose a risk penalty upon an IPO when such a penalty has not otherwise been provided for by the Legislature.

Department staff also relies upon a provision of the statute continued from the old law that directs the Department to issue integration orders "upon terms and conditions that are just and reasonable" (ECL 23-0901[3]; see also ECL former 23-0901[3]). Citing the Third Department's statement that "DEC's role in determining what is 'just and reasonable' is the overarching requirement of the statute" (Matter of Western Land Servs., 26 AD3d at 20), staff relies upon the "just and reasonable" clause as an additional source of its discretion to impose a risk penalty on IPO's in the absence of express legislative language. However, under standard rules of statutory construction, whenever the Legislature has included a general and a particular provision in the same statute, the general does not overrule the particular, but applies only where the particular provision is inapplicable (see People v Lawrence, 64 NY2d 200, 204 [1984]; Statutes § 238). Thus, the Department's general authority to issue integration orders on "just and reasonable" terms and conditions should not be read as overriding the particular provisions of the new law specifying

the right of IPOs to participate in a well at cost and without a risk penalty (see Jiggetts v Grinker, 75 NY2d 411, 419 [1990] [a general grant of discretion does not override specific statutory provisions]).

The legislative history of the 2005 amendments further supports the conclusion that Department staff's discretion to modify the election rights of IPO's in the transition well context is significantly limited, if not eliminated all together. Prior to the 2005 amendments, the compulsory integration provisions of the old law were spare. The old law did require that integration orders make provision for the sharing among owners of the actual costs for drilling, equipping, and operating a well, plus a reasonable charge for supervision (see ECL former 23-0901[3]). It also provided for a 100 percent risk penalty for owners who paid well costs out of production proceeds, the old law equivalent of the NPO (see id.; see also Matter of Terry Hill South Field, Second Interim Decision of the Assistant Commissioner, June 7, 2007, at 10-12). Otherwise, the old law left the integration process to the Department's broad discretion, subject to the "just and reasonable" terms and conditions standard referred to by the Third Department in Matter of Western Land Servs. The old law, in fact, made no express reference to the royalty interest, a status that the Department created, in the exercise of its "just and reasonable" discretion, to integrate owners that did not want to lease their interest or otherwise participate as a working interest (see Terry Hill South Field, at 14 n 5; DR 23-14, at 16, 17). Nor did it precisely define the ownership interests involved, or provide explicit procedures for integrating interest.

In contrast, the new law provides a highly detailed compulsory integration process, defines new terms, and clarifies or explains other terms from the old law, all with the purpose of removing the uncertainty associated with the unitization and integration process under the old law and legislatively allocating the risks and responsibilities among operators and owners (see Senate Mem, at 2254). The new law, therefore, represents a legislative effort to limit the broad discretion that existed under the old law, at least in the areas where the Legislature expressly acted.

To the extent any discretion remains to the Department to modify the election rights of IPOs, Department staff improvidently exercised that discretion in seeking to impose the transitional well formula on IPOs. Article 23 evinces a clear

legislative preference for integration through voluntary agreement among mineral rights owners (see ECL 23-0701; ECL 23-0901[3]). The title 9 compulsory integration process stands as a backdrop to the title 7 voluntary integration process, establishing the framework within which operators and other owners negotiate their voluntary agreements. As such, title 9 provides the base positions from which the various owners in a spacing unit negotiate their private agreements, and must be viewed as the minimum, legislatively-balanced allocation of risks and responsibilities among those owners in the event negotiations fail.

One of the controversies the old law engendered concerned the uncontrolled owner's right to participate as a working interest. At the time the 2005 amendments were adopted, the issue had been the subject of litigation in both the administrative and judicial forums. As noted above, one of the "most important" revisions in the 2005 amendments was to make explicit the three basic options for mineral interest owners -- the IPO, NPO, and integrated royalty owner options -- and to vest in those owners the right to make their own election as to those options (see Senate Mem, at 2254-2255). Thus, the Legislative choice for solving the controversy was to clarify the uncontrolled owners' rights and, incidentally, strengthen their negotiating position.

The Department has long had a policy of non-interference in the voluntary agreement process, leaving the negotiation of such agreements to the marketplace instead (see DR 23-14, at 7). To impose the transition well formula upon IPOs and thereby readjust their negotiating position constitutes an interference in the voluntary agreement process and a weakening of the IPO's legislatively-established bargaining position. This is in stark contrast to the legislative goal of clarifying and strengthening the IPO's options and position. Moreover, the Department's attempt to exercise discretion to readjust the IPOs' rights again introduces uncertainty into the integration process, also in contravention of stated legislative goals.

Department staff justifies its proposal on the ground that it is necessary to take the lack of risk faced by the uncontrolled owners into account in the transition well context. This justification elevates the legislative goal of balancing risk over all other legislative goals, including the most important goal of clarifying the participation options of uncontrolled owners. Again, as noted above, if the Legislature

considered it necessary to take the lack of risk into account in the transition well context, it could have easily done so. As I previously observed in Drumm 1, the Legislature's determination not to take risk into account "must be viewed as a legislative determination that for those relatively few wells that fall into the transitional category, the interests of efficiency and certainty in the establishment of spacing units and the integration of interests therein outweigh the advantages uncontrolled owners would have in making choices with knowledge about the productivity of the subject well" (Ruling, at 6).

Department staff analogizes the transition well context to the provision of the new law governing modified spacing units (see ECL 23-0503[6]). Staff argues that because the Legislature took risk into account for wells already in production in modified units, it is justified in taking risk into account in the transition well context. Staff asserts that WLS is in no worse a position than any other uncontrolled owner under the new law whose mineral rights are included in a spacing unit where the initial well is already in the risk penalty phase.

However, a close examination of the referenced provision supports WLS's position, not Department staff's. Subdivision (6) expressly provides that "[i]f the initial risk penalty phase pursuant to title 9 of this article is still in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article" (id. [emphasis added]). Nothing in subdivision (6) would impose a risk penalty on a new uncontrolled owner included in a modified unit that elects to participate as an IPO.

Most significantly, subdivision (6) goes on to provide that "[i]f the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only" (id.). Thus, far from imposing a risk penalty on an IPO, the statute eliminates the NPO status, and its risk penalty, entirely. Thus, the analogy to subdivision (6) does not support staff's position.

In addition, subdivision (6) leaves participation status to the election of the uncontrolled owner, not staff. Here, staff has elected to eliminate the IPO status. Thus, contrary to staff's assertion, an uncontrolled owner is worse

off under the transitional well formula than an uncontrolled owner would be under subdivision (6).

Moreover, staff seeks to impose the risk penalty for a purpose broader than intended by the Legislature. The risk penalty in the statute is designed to reimburse the well operator for the risks associated with essentially financing the well costs of NPOs, who wish to pay well costs out of production proceeds rather than up front. This reading of the statute is supported by the Senate Memorandum in support of the 2005 law, in which it is noted that the new law "increases the risk penalty for owners who wish to make no up front investment in the well, but wish to obtain a potentially greater share in the revenue" (Senate Mem, at 2254). Nothing in the new law or its legislative history indicates that the risk penalty was intended to reimburse a well operator for the risks associated with developing a natural gas formation generally, or to penalize an owner otherwise willing to pay its share of costs upfront simply because the well was known to be productive at the time of election.

Finally, imposition of the transition well formula upon WLS is not just, in the context of these cases. Prior to the 2005 amendments, WLS consistently asserted its right to participate in the subject wells as a working interest, and not to be integrated as a royalty interest only. After WLS's assertion was rejected by well operators and Department staff, WLS resorted to administrative and judicial proceedings seeking recognition of its rights. WLS was finally vindicated when the new law expressly recognized the right of uncontrolled owners to elect to participate as either IPOs or NPOs. In light of this history, it is patently unfair to impose a risk penalty upon WLS when the risk faced by WLS at the integration hearing was a circumstance beyond its control.

In conclusion, chapter 386 of the Laws of 2005 does not authorize the imposition of a risk penalty against uncontrolled owners electing to participate in the transition wells as an IPO. Moreover, Department staff lacks the discretion to impose a risk penalty against IPOs in the transition well context. In the alternative, to the extent the Department's authority to issue integration orders on terms that are just and reasonable encompasses the power to modify the participation rights of IPOs in the transition well context, Department staff improvidently exercised that discretion in these cases. In the specific context of these cases, the

imposition of a risk penalty against IPOs is neither necessary to accomplish the policy objectives of article 23 nor just.

E. Access to Well Data/Well Site Access (All Units Except SRA3 1)

An issue common to all units except SRA3 1[10] is whether IPOs and NPOs are entitled to access well data and the well site without any Department-imposed terms of confidentiality. This issue was also presented in Matter of Beach W1, et al. (see ALJ Ruling, at 18-25), and is presently on appeal before the Commissioner.

At the issues conference, the parties agreed that the issue has been sufficiently argued and briefed in other proceedings. The parties also agreed that the Commissioner's decision in Beach W1 will control the outcome of the issue in these cases as well.

In Beach W1, I concluded that the issue presented is adjudicable, requiring further record development before the issue may be decided. For the reasons stated in Beach W1, I conclude that the issue is adjudicable in these proceedings as well.

As provided below, the parties may appeal this ruling to the Commissioner and, thereby, join these proceedings with the appeals presently before the Commissioner. In the event the parties do not appeal this ruling, I will nonetheless adjourn adjudication of the issue, based upon the parties' agreement that the Commissioner's decision in Beach W1 will control in these cases as well.

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[10] At the issues conference, the parties agreed that the access to well data/well site access issue has been resolved for the SRA3 1 well (see Drumm 1, et al. IC Trans, at 7-26). At the October 23, 2007, integration hearing for the SRA3 1 well, Fortuna and WLS agreed to enter into a confidentiality agreement governing well data and other information. The confidentiality agreement was executed October 29, 2007 (see Letter from Thomas S. West to Chief ALJ McClymonds, Nov. 8, 2007, Stipulation, Exh A).

CONCLUSION -- SUMMARY OF RULINGS

1. Well Operators' Authority to Drill Prior to Completion of the Compulsory Integration Process (Bosket 1 and Winter 1-A Units)

Under section 23-0501(2)(b), a well operator has the right to drill a well upon issuance of a well permit and prior to issuance of an integration order, provided the well operator controls the relevant mineral interests in the parcels within a spacing unit through which the wellbore passes. If the operator exercises that right, however, it does so at its sole risk and without prejudice to the uncontrolled owners' right to elect their participation status under title 9 of article 23. On the other hand, if the well operator does not control the mineral interests in the parcels through which the wellbore passes, the well permit will contain a condition requiring completion of the title 9 integration process before the right to drill may be exercised by the well operator. Any violation of this condition would expose the well operator to enforcement proceedings.

No factual issues regarding this issue are in material dispute. Accordingly, the issue will not be subject to further adjudication.

2. Costs for Subsequent Operations Conducted Prior to Integration (Winter 1-A)

After the issues conference, Fortuna withdrew this issue. Accordingly, the issue has been resolved and will not be subject to further adjudication.

3. Transition Wells -- Applicability of Laws of 2005, Chapter 386 (Drumm 1, SRA3 1, and Usack 1 Units)

The well operators' request for reconsideration of my decision in Drumm 1 is granted and, upon reconsideration, I adhere to my prior ruling. Chapter 386 of the Laws of 2005 govern the compulsory integration of interests for transition wells that were permitted prior to August 2, 2005, the effective date of the 2005 amendments to article 23, but for which a spacing and compulsory integration order had not been issued. Accordingly, title 9 of article 23, as amended in 2005, governs the integration of interests for the Drumm 1, SRA3 1 and Usack 1 wells.

No factual issues regarding this issue are in material dispute. Accordingly, the issue will not be subject to further adjudication.

4. Transition Well Formula: Application of Risk Penalty to IPOs (Drumm 1, SRA3 1, and Usack 1 Units)

Chapter 386 of the Laws of 2005 does not authorize the imposition of a risk penalty against uncontrolled owners electing to participate in the transition wells as an IPO. Moreover, Department staff lacks the discretion to impose a risk penalty pursuant to its authority to issue integration orders on terms that are just and reasonable. In the alternative, to the extent the Department does have discretion to modify the participation rights of IPOs in the transition well context, Department staff improvidently exercised that discretion in these cases. In the specific context of these cases, the imposition of a risk penalty against IPOs is neither necessary nor just.

No factual issues regarding this issue are in material dispute. Accordingly, the issue will not be subject to further adjudication.

5. Access to Well Data/Well Site Access (All Units Except SRA3 1)

For the reasons stated in Beach W1, I conclude that the issue concerning the uncontrolled owners' right to access well data and the well site without any Department-imposed terms of confidentiality is adjudicable in these proceedings as well. I adjourned adjudication of this issue until after the issuance of the Commissioner's decision on the appeals in Matter of Beach W1, et al.

ORDERS OF DISPOSITION

Matter of Allington 1

All issues raised by the parties have been either waived or settled and, thus, no issues remained for adjudication. Upon remand, Department staff issued the final compulsory integration order on January 16, 2009 (see DEC Order No. DMN 08-26). Accordingly, the adjudicatory hearing record in Allington 1 is hereby closed.

Matter of Stage 1

Based upon the signed written statements filed on behalf of well operator Chesapeake Appalachia, and uncontrolled owners Southwestern Oil and Buck Mountain, all issues raised in this proceeding have been resolved by confidential agreement of the parties. Accordingly, the matter is hereby remanded to Department staff for issuance of a final order of integration.

APPEALS

With respect to the remaining proceedings, parties to an issues conferences are entitled to appeal as of right to the Commissioner on an expedited basis a ruling to include or exclude any issue for adjudication, a ruling on the merits of any legal issue made as part of an issues ruling, or a ruling affecting party status (see 6 NYCRR 624.8[d][2]). Under Part 624, the parties would have ten days from the date this ruling is mailed to file their appeals (see 6 NYCRR 624.6[e][1], [b][2][i]). The ALJ has the discretion, however, to modify regulatory time frames to avoid prejudice to the parties (see 6 NYCRR 624.6[g]).

Accordingly, to avoid prejudice to the parties, the appeals schedule is as follows. Appeals, if any, are due by close of business Wednesday, November 25, 2009. Replies are due by close of business Wednesday, December 9, 2009.

Send the original and three copies of all submissions to Commissioner Alexander B. Grannis, c/o Louis A. Alexander, Assistant Commissioner for Hearings and Mediation Services, New York State Department of Environmental Conservation, 625 Broadway, 14th Floor, Albany, New York 12233-1010, and one copy of all submissions to all others on the active parties service list at the same time and in the same manner as transmittal is

made to the Commissioner. The Commissioner will forward two copies of the submissions he receives to the presiding Chief ALJ. Submissions by electronic mail or telefacsimile are authorized, so long as a conforming hard copy is sent by regular mail and postmarked by the deadline.

Appeals and any responses thereto should address the ALJ's rulings directly, rather than merely restate a party's contentions and should include appropriate citations to the record and any exhibits introduced therein.

FURTHER PROCEEDINGS

I will convene a conference call with the parties to determine whether there are proceedings that should continue while appeals, if any, are pending. This will include proceedings to issue spacing orders for transition wells for which a spacing order has not been issued pursuant to ECL 23-0503(5) (see Matter of Fred Andrews 1-A, Interim Decision and Order of the Commissioner, Jan. 7, 2009, at 12-14).

/s/
James T. McClymonds
Chief Administrative Law Judge

Dated: November 4, 2009
Albany, New York

Attachments

TO: Active Parties Service List (Drumm 1, et al.)
Service Lists (Allington 1 and Stage 1)

STATE OF NEW YORK
DEPARTMENT OF ENVIRONMENTAL CONSERVATION

In the Matter of Integration of Interests
Within an Individual Spacing Unit pursuant
to Environmental Conservation Law ("ECL")
§23-0901(3) known as,

Stage 1.

AFFIDAVIT OF KATHLEEN SANFORD IN OPPOSITION TO CHESAPEAKE APPALACHIA'S MOTION FOR SUMMARY DISMISSAL

STATE OF NEW YORK)
COUNTY OF ALBANY) ss.:

KATHLEEN SANFORD, being duly sworn, deposes and says:

1. I have been employed in the Division of Mineral Resources in the New York State Department of Environmental Conservation ("DEC" or "Department") since 1985, and since 1999 I have served as the Permits Section Chief in the Bureau of Oil and Gas Regulation, Division of Mineral Resources. I submit this affidavit in support of Department staff's opposition to Chesapeake Appalachia's Motion for Summary Dismissal.

2. As Permits Section Chief, I am familiar with all regulatory proceedings since 1999 involving well spacing and compulsory integration in New York, as well as with a variety of other regulatory matters pertaining to Article 23 of the Environmental Conservation Law.

3. I was involved with the preparation for and attended all Department hearings held pursuant to ECL §23-0501 and ECL §23-0901 between 1999 and 2003, assisted with the preparation of various pre- and post-hearing Department filings, and am familiar with the associated controversies which led first to issuance of Declaratory Ruling #23-14 and ultimately to the major amendments which were signed into law on August 2, 2005 as Chapter 386 of the Laws of 2005 ("amendments").

4. On the behalf of the Division of Mineral Resources and the Department, I was responsible with others for reviewing the proposed amendments, participating in discussions with the legislative sponsors and negotiating with the industry proponents. I am familiar with the background and intent of the amendments.

5. I was involved with the preparation of *DEC Program Policy DMN-1: Public Hearing Processes for Oil and Gas Well Spacing and Compulsory Integration* and am familiar with its background and intent ("DMN-1"). With others in the Department, I was responsible for development and implementation of the current compulsory integration hearing process based on DMN-1 and the amendments.

6. The statements herein are based upon knowledge obtained in the course of my duties in the Division of Mineral Resources, including: personal review of Department records;

conversations with other DEC personnel; recollection of meetings that took place between January 2005 and June 2005 within DEC, between DEC and industry, and between DEC and the legislative sponsors regarding the amendments; and work and discussions related to development and implementation of DMN-1.

7. A compulsory integration hearing was held by Department staff on February 6, 2008, in order to receive the elections of uncontrolled owners and to hear any objections to draft compulsory integration order number DMN 08-10 for the Stage 1 unit. There are five uncontrolled parcels in the Stage 1 unit, one of which is controlled by Buck Mountain Associates, Inc. ("Buck Mountain"). During this proceeding, Buck Mountain raised an objection to the drilling of the well prior to entry of a compulsory integration order. The issue is expected to be referred to the Office of Hearings and Mediation Services upon receipt of the integration hearing transcript.

8. Chesapeake Appalachia, LLC ("Chesapeake") has filed a motion to dismiss the drilling issue as an issue for adjudication on the grounds that Environmental Conservation Law Article 23 or its implementing regulations does not prohibit drilling ahead of an integration order and that the construction of the statute itself defeats Buck Mountain's claim that an integration order must be issued before drilling can commence. Chesapeake also asks for interim

relief from the Commissioner to allow Chesapeake to implement compulsory integration terms when no order has been issued from the Department.

9. First, Chesapeake's motion for dismissal of the drilling issue is premature. The record created in the Stage 1 integration hearing has not been officially forwarded to OHMS for adjudication. In the ordinary course of administering these hearings, the hearing officer waits until the integration hearing transcript is received before sending a transmittal memo to OHMS for review. Therefore, until the record is transmitted to OHMS there is no issue ripe for review and time remains for the parties in dispute to enter a voluntary agreement which would allow the order to be issued without further Department involvement or proceedings.

10. In addition, both DMN-1 and ECL §23-0901 indicate that if Department staff finds that a substantive and significant issue has been raised during the integration hearing, then the matter is referred to OHMS for an adjudicatory hearing. During the negotiations on the statute, the parties, which included representatives from industry, specifically discussed whether the statute should simply indicate that a "hearing" will be held when staff finds that a substantive and significant issue has been raised or whether an "adjudicatory

hearing" should be specifically named. The language adopted in 2005 specifically mentions an "adjudicatory hearing." To Department staff, this means that a hearing pursuant to 6 NYCRR Part 624 must be held once a proceeding is referred by the Division of Mineral Resources to OHMS. Furthermore, the Department's regulations and DMN-1 do not indicate that the well operator has the right to challenge Department staff's determination.

11. Nevertheless, as one of the Department's representatives in the negotiations for the new law, I can confirm that the industry representatives who participated in the negotiations specifically argued for the ability to drill wells ahead of an integration order when an integration order was required, so that the compulsory integration process would not unduly delay drilling in the face of disputes, lease expirations or rig scheduling pressures. The negotiations that took place prior to June 2005 were extensive and involved many different parties and many different draft legislative proposals. However, one of the constants during the negotiations was the industry's conviction that operators be allowed to drill wells ahead of integration orders in all circumstances, except one, and industry's position prevailed.

12. The one exception from the operator's right to drill once a permit is issued is if the path of the wellbore includes

an uncontrolled tract. In this case, the permit will be issued so that the compulsory integration hearing can be commenced, but work under the permit may not begin until the integration order is issued. This concept was eventually adopted as ECL §23-0501(2)(b).

13. Buck Mountain interprets "rights in the target formation to be penetrated by the wellbore" to mean that the entire formation included in the spacing unit must be controlled by the operator in order to commence drilling. I will concede that it is possible, as Buck Mountain has, to read too much into the phrase "the oil and gas rights in the target formation" but I can confirm that the right to drill the well, with the exception noted above, was not intended to be dependant on whether an integration order was issued, even though all parties agreed this would be the preferable sequence of events and the industry representatives repeatedly stated that drilling ahead of the order would be rare.

14. Buck Mountain also relies on the language in DMN-1 to indicate that elections need to be received before a well is drilled. It was certainly the Department's hope and expectation that most wells would not be drilled prior to issuance of the integration order, but the language referenced by Buck Mountain is not directory. The main focus of the 2005 amendments was to

ensure that some risk was present at the time of making an election to participate in the unit. By separating the spacing and integration processes, the new law rectified one of the main problems under the old law where permits to drill were issued before spacing units were even established. The introduction to the Policy section of DMN-1 states that "the required agency review must be conducted promptly and with a frequency that [does not prohibit] appropriate consideration of risk by potential well participants . . ." But this language, or the language cited by Buck Mountain, does not dictate that the operator cannot drill the well ahead of an integration order.

15. In its motion, Chesapeake also asks the Commissioner for interim relief, to allow Chesapeake to avail itself of the procedures listed in ECL 23-0901(3)(c)(1)(ii)(E) & (H). Paragraphs (E) & (H) would allow Chesapeake to conduct subsequent operations on the unit and seek payment, within mandated timeframes, from owners who elected to be either participating or non-participating owners in the unit. Without an integration order, owners remain uncontrolled and are not yet eligible to receive production revenue from the initial well. Those owners would therefore be put at a significant disadvantage if they are then asked to pay their share of the costs of subsequent operations. Department staff therefore opposes Chesapeake's motion for interim relief.

16. As Chesapeake indicated, the real dispute in this matter concerns the sharing of well data. Buck Mountain has requested access to well data upon integration as a participating owner and without a confidentiality agreement; Chesapeake refuses to supply it. Chesapeake accuses Buck Mountain of raising the drilling issue as a means to leverage the compulsory integration process to force Chesapeake to sign a joint operating agreement and in retaliation, Chesapeake raises the data access issue to prevent Buck Mountain from making an informed decision on the subsequent operations that they seek to conduct with the Commissioner's permission.

17. Any granting of interim relief that allows Chesapeake to proceed with (E) & (H) notices should also require data to be shared when it is collected (regardless of whether a confidentiality agreement is in place). If data has not been shared, then any of the required timeframes for elections provided in (E) & (H) should start from the date that data is provided. In almost all other proceedings, Chesapeake has agreed to comply with the data access language included in the draft order of integration subject to the decision from OHMS in the Dzybon proceeding. *See*, Affirmation of Thomas S. West, Paragraph 28. Therefore, a requirement to provide the data when it is collected under any interim order would be consistent with Chesapeake's position in almost all other proceedings.

18. Again, as one of the Department's representatives in the intensive negotiations that took place prior to introduction of the 2005 legislation, I respectfully submit that it was not anyone's intent or expectation that the Commissioner would be called upon to, as in a sense has been requested here in Chesapeake's request for interim relief, dictate the workings of the business relationship between the well operator and prospective participating owners in a spacing unit. While Chesapeake asserts that Buck Mountain is attempting to force a joint operating agreement and characterizes such in negative terms, Department staff strongly believes that a joint operating agreement would indeed be the preferred method of handling all of the matters at issue, i.e., data sharing, sharing of gathering line costs, and elections for subsequent operations. If granted, the interim relief requested by Chesapeake, even if modified to require immediate data sharing, would remove any incentive for continued private negotiations on the real issues in this matter. Furthermore, it would set a precedent whereby parties in future units would simply revert to a similar request to the Commissioner rather than engage in good-faith negotiations to reach a private business agreement to govern the day-to-day affairs associated with well drilling and development.

19. Finally, even if interim relief were appropriate, it should be granted in the form of an order that parties should have the opportunity to review and comment upon in draft form. Issues such as the timing of data sharing, deadlines for elections and payments, and payment of production revenue should be vetted before such an order is finalized. The appropriate venue for this is the adjudicatory hearing that staff expects will be requested upon the hearing officer's review of the transcript, bringing us once again to the conclusion that Chesapeake's motion to the Commissioner is premature.

____________/s/________________
KATHLEEN SANFORD

Sworn to me this 6th day of March, 2008

___________/s/____________

Rebecca Denue